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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, JUNE 9, 2000

APPLICATION OF

THE POTOMAC EDISON COMPANY  
d/b/a ALLEGHENY POWER

CASE NO. PUE000280

For approval of a  
functional separation plan

ORDER FOR NOTICE AND COMMENT

On May 25, 2000, The Potomac Edison Company d/b/a Allegheny Power ("AP" or "Company") filed an application, pursuant to §§ 56-77, 56-90, 56-88.1 (to the extent this provision is applicable), and 56-590 B of the Code of Virginia, for approval of a plan (the "Plan") for the functional separation of its generating assets from its transmission and distribution assets, as required by the Virginia Electric Utility Restructuring Act (the "Act").

To accommodate retail choice of electricity generation supply in Virginia, AP proposes to separate its generation facilities from its transmission and distribution facilities by transferring most of its generating assets, certain utility securities and contractual entitlements to generation to an affiliate called "GENCO." This entity would operate the generation facilities and AP would continue to own the

transmission and distribution plant in Virginia, read meters, and bill customers as an energy delivery company.

In Phase I of the Plan, AP is requesting Commission approval to transfer to GENCO, effective July 1, 2000, all of its undivided interests in its generating facilities, with the exception of certain hydroelectric facilities in Virginia having an aggregate capacity of less than 5 MW. In addition, as part of Phase I, AP will transfer to GENCO all of its shares of the stock of Allegheny Generating Company, which holds a 40% interest in the Bath County Pump Storage Project, located in Bath County, Virginia. These transfers would be made at book value.

AP also plans to transfer to GENCO as part of Phase I of the Plan, its rights and responsibilities outlined in an inter-company power agreement, dated July 10, 1953, with the Ohio Valley Electric Cooperative ("OVEC"). Under this agreement, AP has certain obligations to sell power to and, at times, purchase power from OVEC. Final transfer of its interests in the OVEC contract will require further action of the Federal Energy Regulatory Commission ("FERC"), but AP is requesting approval of the Phase I transfer of its rights and responsibilities in this proceeding.

Finally, AP proposes to transfer to GENCO its rights and responsibilities under the operating agreements it is now party

to for the operation of the generating plants it seeks to transfer to GENCO, and the Company seeks interim approval to transfer to GENCO certain "incidental interconnection, access and easement" agreements between it and other affiliates that would be necessary to enable GENCO to operate the generating plants. Any such agreements would be further identified and final approval of transfer would be requested in a Phase II proceeding to be filed at a later date. During this Phase II, the Company would also file unbundled rates, establish necessary codes of conduct to prevent cross-subsidization, and provide other information or tariff modifications required by the Commission and necessary for compliance with the Act and Commission rules and regulations.

AP has filed, as part of its application, a Memorandum of Understanding ("MOU") with the Commission's Staff ("Staff"). The MOU contains certain representations and undertakings that AP has made for purpose of compliance with the requirements of the Act. The Company has agreed to make a reduction to its annual Virginia jurisdictional base rate revenues by \$1 million, effective July 1, 2000, with the reduction applied ratably to each rate classification. Further, AP agrees not to file an application for a base rate increase prior to January 1, 2001. Under the Act, the effect of this undertaking will be a freeze of the Company's base rates through at least January 1, 2004.

AP has agreed to operate and maintain its distribution system in Virginia at or above historic levels of service quality and reliability, and to implement, on a timely basis, distribution system improvements necessary to maintain the quality of its service. During the period in which AP provides default service as provided by the Act, it will contract for generation services to be provided to these customers at the same cost that it would incur to serve customers from the units it now owns, but would divest to GENCO under the Plan.

The final aspect of the MOU involves modification to the manner in which the Company recovers its fuel costs. Beginning July 1, 2000, AP proposes to terminate the fuel factor mechanism and instead recover its fuel costs through its base rates. The Company and Staff have agreed in the MOU that the costs currently recovered through the Company's fuel factor would be rolled into the base rates effective July 1, 2000, at an effective rate of 1.181 cents/kWh. Thereafter, the Company will forego any fuel cost adjustments that would otherwise be permitted under the Act. The Company will neither collect any prior under-recovery of fuel costs or refund any prior over-collection of such costs. Under this proposal, customers' base rates would increase effective July 1, 2000, since revenue generated by the fuel rate to be rolled into base rates exceeds the revenue collected by the currently effective fuel factor by

more than the \$1 million reduction in base rates planned for concurrent implementation on that date. However, the Company's customers would be protected from fuel cost increases for the entire period during which AP's rates would be capped by the Act.

Therefore, together with the proposals contained in the MOU, AP requests approval of:

1. its transfer of generating assets to GENCO at book value;
2. its transfer of its shares of stock in AGC to GENCO at book value;
3. its assignment of its rights and interests in the OVEC agreement to GENCO; and
4. its assignment of certain incidental and operating agreements to GENCO.

Further, the Company requests that the Commission retain jurisdiction over these matters for consideration, in a Phase II proceeding, of further filings to be made with regard to its additional restructuring activities.

NOW THE COMMISSION, upon consideration of this matter, is of the opinion that notice should be given to the public of AP's application, and interested parties should be given an opportunity to comment or request hearing on issues other than the fuel factor. We will schedule a hearing on the fuel factor

issue and establish a procedural schedule for the filing of pleadings, testimony, and exhibits.

Accordingly, IT IS ORDERED THAT:

(1) This matter is docketed and assigned Case No. PUE000280;

(2) A hearing is hereby scheduled for 10:30 a.m., July 20, 2000, in the Commission's courtroom on the second floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia, for the purpose of receiving evidence related to the issue of the Company's fuel factor.

(3) AP shall make its application available for inspection by the public, who may obtain a copy by requesting it in writing from AP's counsel, Philip J. Bray, Esquire, Allegheny Power, 10435 Downsville Pike, Hagerstown, Maryland 21740; or who may inspect the application and all subsequently filed material at the office of the Clerk of the Commission, State Corporation Commission, Tyler Building, 1300 East Main Street, Richmond, Virginia.

(4) Any person wishing to comment on AP's application, including the MOU, shall file such comments on or before June 30, 2000. Comments should include a statement of the interest of the party in the proceeding, and should state whether the person has an objection to the Commission giving expedited consideration to the proposed Phase I transfers.

(5) Any person desiring a hearing on issues other than the fuel factor shall file such request on or before June 30, 2000, and shall state in the request the specific aspects of the application upon which hearing is sought, and shall identify the evidence the party proposes to offer at any hearing.

(6) An original and twenty (20) copies of any request or comment shall be filed with the Clerk of the Commission, P.O. Box 2118, Richmond, Virginia 23218, and make reference to Case No. PUE000280.

(7) On or before June 27, 2000, any person desiring to participate as a Protestant, as defined in SCC Rule 4:6, shall file with the Clerk, Document Control Center, P.O. Box 2118, Richmond, Virginia 23218, an original and twenty (20) copies of a Notice of Protest as provided in SCC Rule 5:16(a) and serve a copy on the Company.

(8) On or before June 30, 2000, each Protestant shall file an original and twenty (20) copies of a protest (SCC Rule 5:16(b)) and of the prepared testimony and exhibits Protestant intends to present at the hearing, and serve two (2) copies of each on the Company and all other Protestants.

(9) On or before July 10, 2000, the Commission's Staff shall investigate the reasonableness of AP's application including the proposed fuel factor and file either a report or

testimony with the Clerk, sending a copy to the Company and each Protestant.

(10) On or before July 17, 2000, the Company and interested persons may file with the Commission an original and twenty (20) copies of comments on the Staff report on issues other than the fuel factor, and the Company may file rebuttal on fuel factor issues; additional rebuttal evidence may be presented at the hearing by the Company without prefiling, provided it is in response to evidence which was not prefiled but elicited at the hearing and provided further, that the need for additional rebuttal is timely addressed by motion at hearing and leave is granted by the Commission. A copy of the prefiled rebuttal evidence on fuel factor issues shall be sent to all Protestants by AP.

(11) On or before June 21, 2000, AP shall cause to be published the following notice in display advertising in newspapers of general circulation in its Virginia service territory:



NOTICE TO THE PUBLIC OF AN APPLICATION BY  
THE POTOMAC EDISON COMPANY, d/b/a ALLEGHENY  
POWER, FOR APPROVAL OF A PLAN FOR FUNCTIONAL  
SEPARATION OF ITS GENERATION FACILITIES,  
UNDER THE VIRGINIA ELECTRIC UTILITY  
RESTRUCTURING ACT, AND CONSEQUENT RATE  
ADJUSTMENT DUE TO FUEL EXPENSE  
REDETERMINATION AND ELIMINATION OF SEPARATE  
RECOVERY OF FUEL COST EXPENSE  
CASE NO. PUE000280

On May 25, 2000, The Potomac Edison Company, d/b/a Allegheny Power ("AP" or "Company"), filed an application, pursuant to §§ 56-77, 56-90, 56-88.1 (to the extent this provision is applicable), and 56-590 B of the Code of Virginia, for approval of a plan (the "Plan") for the functional separation of most of its generating assets from its transmission and distribution assets, as required by the Virginia Electric Utility Restructuring Act (the "Act").

To accommodate retail choice of electricity generation supply in Virginia, AP proposes to separate its generation facilities from its transmission and distribution facilities, by transferring most of its generating assets, certain utility securities and contractual entitlements to generation to an affiliate called "GENCO." This entity would operate the generation facilities and AP would continue to own the transmission and distribution plant in Virginia and proposes to read meters and bill customers as an energy delivery company.

AP's Plan includes the imminent transfer of its interests in virtually all of its generating facilities, and the transfer of its shares of Allegheny Generating Company, which own a 40% interest in the Bath County Pump Storage Project in Bath County, Virginia, to GENCO. The Company proposes to make these transfers effective July 1, 2000, at book value.

Coincident with these transactions, AP would assign to GENCO its rights and responsibilities in the operating agreements for the generating facilities it owns in common with its other affiliates, Monongahela Power and West Penn Power. The Company will retain, for now, ownership in certain small hydroelectric facilities in Virginia.

AP further proposes to transfer to GENCO its rights and responsibilities in an Inter-Company Power Agreement with the Ohio Valley Electric Cooperative ("OVEC"). Under this Agreement, AP makes certain sales of power to, and purchases of power from, OVEC. As the final part of the Plan, AP would assign to GENCO its rights and interests in certain incidental interconnection, access and easement agreements necessary for GENCO's operation of the generating plants.

As part of its application, AP has filed a Memorandum of Understanding ("MOU") negotiated with the Staff of the State Corporation Commission ("Staff"). In the MOU, the Company has made certain representations and undertakings for purpose of compliance with the requirements of the Act. The Company proposes to reduce its base rates to its Virginia customers by \$1 million, effective July 1, 2000, and thereafter not to file for a base rate application, as otherwise permitted by the Act, prior to January 1, 2001. The effect of this undertaking is to freeze the Company's base rates through the period in which it provides default service in its Virginia service territory. Concurrent with the base rate reduction, the Company proposes to eliminate separate recovery of fuel expenses through the fuel factor, and to recover fuel costs at the level of 1.181 cents/kWh, in its base rates. This represents an increase from the Company's currently effective interim fuel factor of 1.013 cents/kWh. Further, the Company will

forego any rate increases associated with fuel costs that would otherwise be permitted under the Act during the rate cap period established by the Act. Additionally, the Company will neither collect any prior under-recovery of fuel costs or refund any prior over-collection of such costs.

The result of the elimination of the separate fuel cost recovery mechanism and the re-calculation of the amount of expense to be included in base rates at a level of 1.181 cents/kWh will increase the Company's regulated operating revenues by approximately \$4.2 million on an annual basis before consideration of the \$1 million base rate reduction. A residential customer using 1000 kWh of electricity per month will see a monthly increase in his bill of \$1.68 without the base rate reduction.

Pursuant to § 56-249.6 of the Code of Virginia, the Commission has scheduled a public hearing to commence at 10:30 a.m. on July 20, 2000, in the Commission's courtroom, second floor, Tyler Building, 1300 East Main Street, Richmond, Virginia, to receive evidence related to the issue of the Company's fuel factor.

A copy of AP's application is available for public inspection during regular business hours (8:15 a.m. to 5:00 p.m.) in the Commission's Document Control Center located on the first floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia, and may be obtained, by written request directed to AP's counsel, Philip J. Bray, Esquire, Allegheny Power, 10435 Downsville Pike, Hagerstown, Maryland 21740-1766.

Any interested person wishing to comment on the application or request a hearing on issues other than the fuel factor application shall file an original and twenty (20) copies of such comment or

request on or before June 30, 2000, with the Clerk of the Commission, P.O. Box 2118, Richmond, Virginia 23218, making reference to Case No. PUE000280, and serving a copy of such comment or request on AP's counsel. Comments should state the person's interest in the proceeding, and state whether the person has any objection to the Commission giving expedited consideration to the proposed Phase I transfers. Requests for hearing on issues other than the fuel factor should indicate the precise aspect of the Application upon which hearing is sought and the evidence the person expects to introduce at any such hearing.

On or before June 27, 2000, any person desiring to participate as a Protestant on fuel factor issues, as defined in SCC Rule 4:6, shall file with the Clerk, Document Control Center, P.O. Box 2118, Richmond, Virginia 23218, an original and twenty (20) copies of a Notice of Protest as provided in SCC Rule 5:16(a) and serve a copy on the Company.

On or before June 30, 2000, each Protestant in the fuel factor hearing shall file an original and twenty (20) copies of a protest (SCC Rule 5:16(b)) and of the prepared testimony and exhibits Protestant intends to present at the hearing, and serve two (2) copies of each on the Company and all other Protestants.

On or before July 10, 2000, the Commission's Staff shall investigate the reasonableness of AP's application including the proposed fuel factor and file either a report or testimony with the Clerk, sending a copy to the Company and each Protestant.

On or before July 17, 2000, the Company and interested persons may file with the Commission an original and twenty (20) copies of comments on the Staff report on issues other than the fuel factor, and the

Company may file rebuttal on fuel factor issues; additional rebuttal evidence may be presented at the hearing by the Company without prefiling, provided it is in response to evidence which was not prefiled but elicited at the hearing and provided further, that the need for additional rebuttal is timely addressed by motion at hearing and leave is granted by the Commission. A copy of the prefiled rebuttal evidence shall be sent to all Protestants by AP.

THE POTOMAC EDISON COMPANY  
D/B/A ALLEGHENY POWER

(12) On or before June 21, 2000, AP shall serve a copy of its application and this Order on the Chairman of the Board of Supervisors and the Mayor, or Town or City Manager, of each county, city, and town in which it provides service in Virginia. AP shall file with the Clerk of the Commission proof of service on such individuals on or before June 19, 2000.

(13) On or before June 23, 2000, AP shall file with the Clerk of the Commission proof of the notice ordered above.

(14) AP, and any Protestant herein, shall respond to interrogatories within five (5) days of receipt of same. Except as modified herein, discovery shall be in accordance with Part VI of the Commission's Rules of Practice and Procedure.

(15) This matter is continued for further orders of the Commission.